



AUSTRALIAN RAIL TRACK CORPORATION LTD

PRODUCTIVITY COMMISSION INQUIRY

ROAD AND RAIL FREIGHT INFRASTRUCTURE PRICING

**AUSTRALIAN RAIL TRACK CORPORATION
SUPPLEMENTARY SUBMISSION**



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1. Introduction

The Council for Australian Governments (“COAG”) is developing a new Competition Policy Reform Agenda (“Agenda”). A number of commitments and studies were initiated at the last COAG meeting in February 2006 to assist with the development of the new reform agenda. These include a review of the economic costs of freight infrastructure and efficient approaches to transport pricing by the Productivity Commission. COAG agreed to a public inquiry into road and rail freight infrastructure pricing and subsequently the Commission invited interested parties to make a submission on any matter they see as relevant to the Terms of Reference.

ARTC has reviewed the submissions posted on the Commission’s website to date. There are numerous issues raised in the submissions to which ARTC responds to below. Specifically, ARTC has grouped its response into 5 main areas:

- Current Road and Rail Pricing Structures and Competitively Neutral Pricing.
- Mass-Distance Charging (MDC).
- Social Cost of Infrastructure Usage (“Externalities”).
- Impact of Vertical Separation in the Rail Market.
- Nature and Term of Rail Access Undertakings.

2. Current Road and Rail Pricing Structures and Competitively Neutral Pricing

In relation to current road and rail pricing structures and the concept of competitively neutral pricing, ARTC notes the following general comments and consistent themes in submissions to the Commission:

- The PAYGO system utilised in road pricing was criticised extensively. Specifically it was argued that PAYGO is not logical nor transparent and that past expenditure was not reflective of future requirements.
- Current road pricing based on averages and network wide aggregates is not reflective of true costs, especially in relation to heavy vehicles. It is widely recognised, even by the Australian Trucking Association in its submission, that certain heavy vehicles are causing significant road damage and maintenance expenses that are under-recovered. The lack of clear data, especially on local roads where it is noted that data is based “...almost on guesswork”¹, is a consistent issue raised.
- A consistently raised issue was the lack of linkage of road charges & revenue raised to road maintenance and investment. It was widely

¹ Australian Local Government Association Submission to the Productivity Commission Inquiry into Road and Rail Freight Infrastructure Costs and Pricing, May 2006, p3

recognised in submissions to the Commission that the linkage between revenue and maintenance and investment is more transparent in rail.

- A limited number of submissions suggested moving rail pricing to a similar basis as currently applied in road.
- It was presented in some submissions that the impact of moving to full economic cost recovery in both road and rail (or in fact any increase in road or rail pricing from current levels) was likely to have a significant impact on freight costs and hence a significant cost to the economy as a whole. Data presented suggested significant increases in the cost of freight if road pricing is increased, for example, the Australian Trucking Association suggests that a 12% freight increase from full cost pricing could result in \$9bn loss in demand².

In its original submission ARTC provided significant detail in relation to its view on the need for competitively neutral pricing and a desire to move towards full economic cost recovery for both road and rail. Following its review of other submissions, ARTC maintains its previous stated position and in response to the points above highlights specifically the following key points.

ARTC supports the AusLink process and the identification of infrastructure investments to meet markets on a multi-modal basis. Investments should be evaluated on an efficient basis and based on efficient modal pricing. Efficient pricing should be underpinned by access to infrastructure on competitively neutral terms.

As a minimum, subsidy of modes should be on an equivalent basis (in terms of recovery of full economic cost). However, as an overarching objective, subsidies by taxpayers should be minimised. On this basis, the relative competitiveness of road and rail will drive efficient investment decisions in each mode.

ARTC does not support moving rail pricing to be on a similar structural basis to current road pricing as has been suggested in some submissions. If that move were to occur, both modes would effectively be underpriced. This will lead to entrenching subsidy of both modes and long-term allocative inefficiency in the wider economy.

ARTC does not support infrastructure subsidy (and therefore pricing) being based on a 'top-down' assessment where a review of transport provision to markets results in a presumably efficient modal split. On that basis, subsidies

² Australian Trucking Association Australian Trucking Association Response to the Productivity Commission's Review of Economic Costs of Freight Infrastructure and Efficient Approaches to Transport Pricing, April 2006, p3

are then set to deliver this modal split and infrastructure pricing is an outcome. Problems with a top-down efficient modal split type model include:

- Significant information requirements (pricing and non-pricing).
- Changing market needs overtime and the ability to modify the presumed efficient modal split accordingly.
- Market complexities.
- Modal outcomes are government driven through investment and subsidy rather than market driven.

ARTC, as per its original submission to the Commission, supports creating a competitively neutral framework for modal competition. This would enable competitive elements of the supply chain to compete efficiently. Market forces would drive modal outcomes and create an efficient mechanism for delivering investment in infrastructure.

In relation to the impact of a significant increase in road freight pricing (eg 12%), ARTC notes that there has been a reported 9.6% increase in the cost of logistics services in the 12-months to the end March 2006³. Research conducted by ARTC has shown road intermodal freight price increases of around 10% – 14% over the last 12 months. These price increases are broadly in line with the 12% increase proposed as the price effect of full economic cost recovery in road. ARTC does not have available data to determine the general economy effect of the recent actual increases in road freight prices however it questions whether they have flowed through to “up to \$9bn loss in demand” for the Australian economy.

In any event, ARTC is seeking competitive neutrality to be targeted in the first instance (whilst minimising subsidies), with the long term target being full economic cost recovery based on long-term assert sustainability. Addressing the long term target may well be an outcome of growth in freight volumes expected over the next 15 years rather than higher pricing. The important thing is that this growth taken up by transport modes is in the most economically efficient manner.

3. Mass Distance Charging (MDC)

In relation to the application of mass distance charging to road, ARTC notes the following comments and consistent themes in submissions to the Commission.

- In terms of implementation and ongoing operation of MDC, numerous submissions argued that MDC is technically, operationally and administratively difficult.

³ Sinclair Knight Merz - Logistics Cost Monitor March 2006 Report

- Australia's large land distances, in comparison to other countries that have implemented a form of MDC, is seen as a reason to not introduce MDC.
- It has been presented that MDC implementation will overly impact regional & remote areas leading to much higher transport prices for those regions. Some submissions suggest Government should reflect, via subsidies or other means, the social desire to service these regions.
- Numerous submissions suggest that, on the basis of equity, if MDC is used in one mode, it should be used in the other.
- A view expressed in many submissions is that MDC offers a more precise link between road charging, use and damage and provides the opportunity to provide appropriate price signals to promote optimum use of the road system and particular freight routes. ARTC supports this view.

ARTC believes that there is potential for the application of technology to deliver road based mass distance charging, at least in the first instance in relation to the contestable component of the road freight market (ARTC's original submission to the Commission focussed on MDC application to the contestable interstate freight markets). ARTC's review of submissions to the Commission, including road authorities such as the Australian Trucking Association, notes a reasonable consensus that 9-10% of the land freight market is considered contestable. Given this consensus, ARTC remains of the belief that there is significant potential for the application of technology to deliver mass distance charging in the first instance in relation to the contestable component of the road freight market.

In relation to the position that application of mass distance charging may overly impact rural and remote regions, ARTC believes that limiting MDC use, in the first instance, to the contestable land freight market will ensure there is minimal impact on regional or remote areas. The majority of regional and remote areas that would be affected do not have a contestable freight transport supplier market.

ARTC is aware that certain parts of the existing road fleet have already invested in GPS tracking technology for fleet and supply chain management. In undertaking its review of submissions to the Commission, ARTC has not been able to locate any significant discussion regarding the current extent and use of GPS technology and whether the application of this available technology could be extended to the contestable freight market. The extent and use of GPS technology in the road transport industry in Australia currently and the ability to extend this to the contestable road freight market should be an area for further research and analysis.

4. Social Cost of Infrastructure Usage (“Externalities”)

In relation to externalities, ARTC has noted the following issues raised consistently in submissions to the Commission:

- Those opposing externality pricing argue that current data is limited and not precise nor accurate hence decisions to apply externality costs cannot be based on sound fact.
- Numerous submissions opposing externality pricing also suggest that full cost recovery from the road & rail freight industries is not the best approach because there is a level of community benefit and cost from freight transport. Hence the community should contribute and this should be via government subsidy of some kind.
- Other submissions have recognised that externalities are significant and as a minimum they suggest starting at the “low range” of estimates and modifying the approach as data improves.
- There is wide recognition of an urban versus rural divide – externalities such as pollution, noise and congestion are typically much more prevalent in urban areas hence pricing of externalities should reflect this.
- There is a position taken in many submissions that many externality costs are internalised already (through insurance etc). Further, numerous submissions note that the degree of internalisation is significantly different between road and rail.

The assertion that the data on externalities is limited and not precise nor accurate is not supported by the increasing volume of research that is available. ARTC reiterates that significant useful work has been undertaken in recent years (eg BTRE, Victorian Department of Infrastructure, QR and other agencies within Australia and overseas). Numerous submissions also referred to other specific research and examples in other countries that have implemented externality charging (eg Sweden and other European countries).

The outcomes and data from this research is sufficient to ascertain at least a nominal initial treatment for both modes that can be improved upon over time. AusLink investment evaluation principles have sought to incorporate quantified environmental impacts and may be useful in this regard. The inclusion of nominal charging for externalities on both modes (net of internalised cost) will create greater awareness and impetus for improved assessment of these costs. Through more refined research over time the charges can be reviewed.

As an objective, subsidy by taxpayers should be minimised. As a minimum, subsidy of modes should be on an equivalent basis (in terms of recovery of full economic cost). Refer to ARTC’s previous submission to the Commission and the discussion above (in Section 2 “Current Road and Rail Pricing

Structures and Competitively Neutral Pricing”) for further discussion regarding ARTC’s view on the equivalent treatment of subsidies between road and rail.

Numerous submissions recognised that some externalities are already internalised in both road and rail. ARTC notes however that there are significant differences in external amenity costs included in Rail’s cost base but not generally included in Road costs. For example:

- Railways are typically required to fence in urban areas for safety to prevent people walking on lines but no such requirement exists for roads.
- Railways are also required to meet part and sometimes full costs of fencing at boundaries to protect landowners – on roads the adjoining landowner meets full costs.
- Railways are required to have firebreaks on the corridor but roads do not despite the perway having the same effective break as a road.
- Rail has to provide pedestrian crossings (including footbridges or tunnels) when these are amenities in the road definition.
- Rail meets either part or all of the costs of level crossings but in road they are considered an amenity to the road user.
- Noise walls are at the railways cost but an amenity in the case of road.
- Rail has to provide its own terminals but truck staging bays and make up depots (road train amalgamation at city outskirts) are not considered road costs and often provided independently.
- Rail pays for the costs of rail safety regulation which provides public amenity but road users do not.
- Rail meets drainage costs and waste water disposal costs.

The inclusion of these items in rail’s cost base demonstrates another degree of variability in the current competitive position between rail and road. ARTC believes that for both modes the cost base should include all costs that would otherwise not have been incurred but for the existence and use of the transport infrastructure (the road or rail).

5. Impact of Vertical Separation in the Rail market

It has been suggested in a limited number of submissions to the Commission that vertical separation has led to a lack of coordination and decision making focus on single elements of the supply chain. ARTC does not believe that this has been the case on the interstate rail network.

The National Audit conducted in 2000 focussed on delivering outcomes for end users and rail operators as well as infrastructure providers. During the process there was significant industry and stakeholder involvement.

ARTC has committed around \$1.5 billion in rail infrastructure investment as part of its North-South Strategy. Like the National Audit, this significant commitment and the process to determine the need for this investment was made with regard to market desired outcomes. Specifically, there was significant consultation to the above rail industry and cost / benefits to all stakeholders were considered in detail during the decision making process. In order to fully achieve the desired market outcomes from this considerable below rail investment, there is a requirement for significant above rail investment and this has not been committed to date.

In relation to the East-West market, ARTC has undertaken significant consultation with above rail operators and has determined that the existing network and performance meets current market need and has done so for some years. Demonstrative of this performance is the fact that rail has 80% of East-West land market share. ARTC has reviewed the next level of investment required on the East-West (for example, 1800m, double stack trains Melbourne – Perth) and in consultation with above rail operators and other stakeholders it has clearly been established that this investment on the East-West delivers lesser ‘market’ return and benefit to above rail operators than North-South investments. Above rail investment to date on the East-West has been greater than that in rail track as this relates to a national asset base involved in many markets.

Vertical separation and the ensuing above rail competition has delivered substantial rail transport cost and service level benefits particularly in East-West interstate corridors. This has led to substantial improvement in rail’s competitive position in these markets. ARTC considers it unlikely that these benefits would have occurred had the industry structure remained vertically integrated.

6. Nature and Term of Rail Access Undertakings

It is noted by ARTC that there is a perceived lack of certainty for investment in interstate rail due to the rail operator not being able to obtain access certainty beyond 5 years.

ARTC advises that it is able and willing to negotiate longer-term (more than 5-year) contractual agreements with rail operators. The terms and conditions of contractual agreements preside over and above the terms and conditions that may arise from any new access undertakings that may apply during the term of a contract between ARTC and an operator.